

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA

In re

FARZIN SHAMS aka FRED SHAMS,  
Debtor.

Case No. 93-5-2472-MM

Chapter 13

**MEMORANDUM OPINION AND  
ORDER THEREON**

**INTRODUCTION**

Before the Court is the motion of Chief Automotive Systems, Inc. for relief from the automatic stay to execute on a prepetition judgment against the debtor for possession of frame repair equipment. For the reasons that follow, Chief Automotive's motion is denied.

**FACTS**

Farzin Shams operated an auto body repair business through his corporation, Auto Investments, Inc., until 1992. On June 24, 1988, Auto Investments, Inc. entered into an Equipment Lease Purchase Agreement with Chief Automotive Systems, Inc. for a Chief E-Z Liner II Frame Straightener. The agreement provided that Automotive Investments would make monthly payments of \$598.01 for a 60-month term commencing on July 10, 1988. The agreement further provided that Auto Investment could purchase the equipment for \$1 at the end of the lease term. It also provided that Chief Automotive Systems, the lessor, would retain title to the equipment and that Auto Investments, the lessee, would be responsible for maintenance of the equipment, pay taxes and provide insurance for the equipment, and

1 bear the risk of loss or damage. Shams personally guaranteed Auto Investments' performance of the  
2 terms of the agreement with Chief Automotive Systems.

3 Auto Investments defaulted under the terms of the Equipment Lease Purchase Agreement by  
4 failing to make the September 1992 payment or any subsequent payments. Shams also failed to honor  
5 the guaranty. Chief Automotive Systems commenced an action in the Santa Clara County Superior Court  
6 for breach of contract and conversion and to recover possession of the equipment. It obtained a default  
7 judgment against Shams and Auto Investments on March 25, 1993. Chief Automotive Systems acquired  
8 a writ of possession, but the Sheriff had not executed on the writ at the time that Shams filed a chapter  
9 13 petition on April, 16, 1993, so the equipment remains in the debtor's possession.

10 Chief Automotive Systems asserts that the fair market value of the equipment is \$26,950 and that  
11 the estimated "as is" value of the equipment in the hands of the debtor is \$18,500. The balance remaining  
12 under the Equipment Lease Purchase Agreement is \$6,916.14, plus attorneys' fees and costs of  
13 \$1,274.50. Chief Automotive Systems has filed a proof of secured claim in the case and characterizes  
14 itself as a secured creditor in its moving papers.

## 15 16 DISCUSSION

17 The questions presented for the Court's determination are whether the frame straightener is  
18 property of the estate, which is subject to the automatic stay of § 362, and if so, whether Chief  
19 Automotive Systems' interest in the equipment is adequately protected.

### 20 A. Scope of Property of the Estate

21 Section 362(a) provides in pertinent part that a bankruptcy petition operates as a stay of:

22 (2) the enforcement, against the debtor or against property of the  
23 estate, of a judgment obtained before the commencement of the case  
under this title;

24 (3) any act to obtain possession of property of the estate or of  
25 property from the estate or to exercise control over property of the  
estate;

26 (4) any act to create, perfect, or enforce any lien against property of  
27 the estate;

28 (5) any act to create, perfect, or enforce against property of the debtor  
any lien to the extent that such lien secures a claim that arose before

the commencement of the case under this title. . . .

11 U.S.C. § 362(a)(2) - (a)(5)(West 1993).

The automatic stay protects property of the estate. Whether the equipment is subject to the automatic stay turns on whether it is property of the estate. Section 541 defines property of the estate to include all legal and equitable interests of the debtor in property as of the commencement of the case. 11 U.S.C. § 541(a)(1). The scope of property of the estate is very broad and includes any property made available to the estate by other provisions of the Bankruptcy Code. United States v. Whiting Pools, Inc., 462 U.S. 198, 205, 103 S. Ct. 2309, 2313, 76 L.Ed.2d 515 (1983). "Property of the estate" means "property over which the estate has control or possession." H.R. Rep. No. 595, 95th Cong., 1st Sess. 341, S. Rep. No. 989, 95th Cong., 2d Sess. 50 (1978). Mere possession is a property interest sufficient to invoke the operation of the automatic stay. David Epstein, Steve Nickels & James White, Bankruptcy § 3-14 (West 1992).

#### **B. Chief Automotive Systems' Interest In The Equipment Under California Law**

The question of what constitutes property for purposes of § 541(a)(1) is a question of federal law. Epstein, supra § 2-8. However, bankruptcy courts must determine the debtor's interest in property by reference to state law. Butner v. United States, 440 U.S. 48, 99 S. Ct. 914, 59 L.Ed.2d 136 (1979). California law determines the extent of Chief Automotive Systems' interest in the equipment.

Under California law, whether a transaction creates a lease or security interest is determined by the facts of each case. Cal. Com. Code § 1201(37). Cal. Com. Code § 1201(37)<sup>1</sup> was

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<sup>1</sup>Cal. Com. Code § 1201(37) provides in part:

(b) Whether a transaction creates a lease or a security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and

(i) The original term of the lease is equal to or greater than the remaining economic life of the goods,

(ii) The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,

(iii) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or

(iv) The lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

(c) A transaction does not create a security interest merely because it provides that

substantially revised effective January 1990 to draw a sharper line between leases and security interests so as to provide greater certainty in commercial transactions. Cal. Com. Code § 1201(37) comment. The determination of whether a transaction creates a lease or a security interest focuses on the economics rather than the intent of the parties. Id. Reference to the case law prior to the Commercial Code provides useful precedent. Id.

Reviewing the factors previously used by the Ninth Circuit, the Court concludes that the arrangement creates a security interest rather than a lessor's reversionary interest. See Interpool Ltd. v. Char Yigh Marine (Panama) S.A., 890 F.2d 1453 (9th Cir. 1989), modified and reh'g denied, 918 F.2d 1476 (9th Cir. 1990); In re Moreggia & Sons, Inc., 852 F.2d 1179 (9th Cir. 1988); In re Pacific Express, Inc., 780 F.2d 1482 (9th Cir. 1986). The combination of factors that are significant to the Court's determination are that the lease payments constitute a full payout, the lessee can purchase the equipment at the end of the lease term for nominal consideration, and the lessee bears all of the risks and burdens of ownership.

Having determined that Chief Automotive Systems is a secured creditor, the next inquiry is the extent of the debtor's interest in the equipment after entry of the default judgment in favor of Chief Automotive Systems. Because Chief Automotive Systems has a security interest in the equipment as defined in Cal. Com. Code § 1201(37), the remedies of division 9 of the Cal. Com. Code are applicable. Puritan Leasing Co. v. August, 128 Cal. Rptr. 175, 182 (Cal. 1976). Cal. Com. Code § 9506 provides:

At any time before the secured party has disposed of collateral or entered into a contract for its disposition . . . or before the obligation has been discharged, . . . the debtor . . . may . . . redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party. . . .

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- (i) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or greater than the fair market value of the goods at the time the lease is entered into,
  - (ii) The lessee assumes the risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,
  - (iii) The lessee has an option to renew the lease or to become the owner of the goods,
  - (iv) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or
  - (v) The lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

1 Cal. Com. Code § 9506 provides the debtor with the right of redemption at any time prior to the  
2 secured party's disposition of the collateral. Clark Equipment Co. v. Mastelotto, Inc., 150 Cal. Rptr.  
3 797, 800-01 (Cal. Ct. App. 1978). See also Thomas H. Jackson, "Avoiding Powers in Bankruptcy,"  
4 36 Stan. L. Rev. 725, 772 (1984).

### 5 **C. Scope Of The Automatic Stay**

6 Secured creditors are constrained in their efforts to repossess once a bankruptcy case has  
7 commenced. 11 U.S.C. § 362(a). As such, Chief Automotive Systems is subject to the stay and  
8 precluded from foreclosing its interest in the equipment if the equipment is property of the estate.  
9 The debtor's pre-foreclosure right to redeem collateral is property of the estate. In re Bialac, 712  
10 F.2d 426, 430-31 (9th Cir. 1983)(pre-foreclosure right to redeem interest in note securing judgment).  
11 Cf. In re Windmill Farms, Inc., 841 F.2d 1467, 1471-72 (9th Cir. 1988)(lease subject to right to relief  
12 against forfeiture is assumable).

### 13 **D. Whether Chief Automotive Systems Is Adequately Protected**

14 A secured creditor is entitled to adequate protection during the period that the automatic stay  
15 is in effect, precluding the creditor from pursuing its state law remedies. 11 U.S.C. § 362(d).  
16 Adequate protection is a flexible concept to be tailored to the circumstances of the case. In re Deico  
17 Electronics, Inc., 139 Bankr. 945 (Bankr. 9th Cir. 1992). An equity cushion may be sufficient to  
18 constitute adequate protection. In re Mellor, 734 F.2d 1396 (9th Cir. 1984). In the case at bar, the  
19 debtor has an equity cushion in excess of \$10,000, or 55%, which is sufficient to provide adequate  
20 protection to Chief Automotive Systems. Additionally, payments to Chief Automotive Systems under  
21 the debtor's amended plan are \$121 per month, which exceeds the rate of depreciation of the  
22 equipment.

### 23 **CONCLUSION**

24 For the reasons stated above, Chief Automotive Systems' motion for relief from the automatic  
25 stay is denied.

26 Good cause appearing, it is SO ORDERED.  
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